United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

11-29-76

76-5025

To be Argued By
Jacob D. Zeldes

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

B

In the Matter of The New York, New Haven
and Hartford Railroad Company, Debtor

P/S

LAWRENCE W. IANNOTTI, Successor Indenture Trustee Under The New York, New Haven And Hartford Railroad Company's First And Refunding Mortgage Dated As Of July 1, 1947; and

JACOB D. ZELDES, Successor Indenture Trustee Under The New York, New Haven And Hartford Railroad Company's General Income Mortgage Dated As Of July 1, 1947,

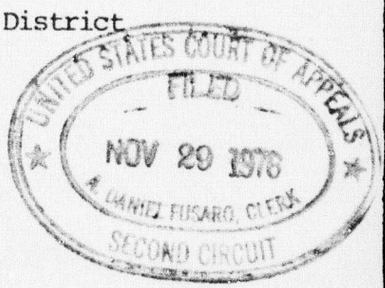
Appellants

MANUFACTURERS HANOVER TRUST COMPANY, Former Indenture Trustee Under The New York, New Haven And Hartford Railroad Company's First And Refunding Mortgage Dated As Of July 1, 1947; and

RICHARD JOYCE SMITH, Trustee Of The Property Of The New York, New Haven And Hartford Railroad Company, Debtor,

Appellees

On Appeal From The United States District Court For The District Of Connecticut, Honorable Robert P. Anderson, Circuit Judge, Sitting By Designation



BRIEF OF SUCCESSOR INDENTURE TRUSTEES

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BRIEF OF SUCCESSOR INDENTURE TRUSTEES

Question Presented

Whether a former indenture trustee under the mortgage of the debtor railroad, as a claimant under §77(c)(12) of the Bankruptcy Act, can recover payments for compensation, expenses and attorneys' fees from the debtor's estate against which it was and remains in conflict by actively pursuing interests adverse to the estate on the central issue of the reorganization.

Statutes Primarily Involved

Section 77(c)(12) of the Bankruptcy Act, 11 U.S.C. §205 (c)(12), provides in pertinent part:

> "Within such maximum limits as are fixed by the Commission, the judge may make an allowance, to be paid out of the debtor's estate, for the actual and reasonable expenses (including reasonable attorney's fees) incurred in connection with the proceedings and plan by parties in interest and by reorganization managers and committees or other representatives of creditors and stockholders, and within such limits may make an allowance to be paid out of the debtor's estate for the actual and reasonable expenses incurred in connection with the proceedings and plan and reasonable compensation for services in connection therewith by trustees under indentures, depositories and such assistants as the Commission with the approval of the judge may especially employ...."

Section 618(b)(4) of the Railroad Revitalization and Regulatory Reform Act of 1976, P.L. 94-210, provides:

> "(b) Section 601(b) of such Act (45 U.S.C. 791(b)) is amended to read as follows:
>
> * * *
>
> "(4) The powers and duties of the Commission under section 77 of the Bankruptcy Act (11 U.S.C. 205), with respect to a railroad in reorganization in the region which conveys all or substantially all of its designated rail properties to the Corporation or a subsidiary thereof, or to profitable railroads in the region, pursuant to the final system plan, and the requirement that plans of reorganization be filed with the Commission, shall cease upon the date of such conveyance. The powers and duties of the Commission under section 77 of the Bankruptcy Act shall also so terminate, as of the date of enactment of this paragraph, with respect to any railroad in reorganization under such section 77 but not subject to this Act which (1) does not operate any line of railroad, and (2)

> has transferred all or substantially all of its rail properties to a railroad in reorganization in the region which was subject to this Act prior to the date of enactment of this paragraph. Thereafter, such powers and duties of the Commission shall be vested in the district court of the United States which has jurisdiction of the estate of any such railroad in reorganization at the time of such conveyance. Such court shall proceed to reorganize or liquidate such railroad in reorganization pursuant to such section 77 on such terms as the court deems just and reasonable, or pursuant to any other provisions of the Bankruptcy Act, if the court finds that such action would be in the best interests of such estate. This paragraph does not affect any obligation of any carrier by railroad subject to regulation under the Interstate Commerce Act. The powers and duties of the Commission under section 77 of the Bankruptcy Act shall continue in effect only to the extent that the railroad in reorganization continues to operate any line of railroad."

Preliminary Statement Required By Local Rule No. 28(2)

On June 30, 1976, the Honorable Robert P. Anderson, Circuit Judge, sitting by designation, rendered the decision from which this appeal is taken (A486), which as yet has not been reported.

Statement Of The Case

These are appeals from an order of the court entrusted with the reorganization of the New York, New Haven and Hartford Railroad Company, awarding payments of compensation and disbursement of expenses to a former indenture trustee which the court found acted in a conflict of interest and which hired two counsel who took directly conflicting positions on the central issue facing reorganization. At issue is the order of the Reorganization Court with respect to the petition of Manufacturers Hanover Trust Company and A.

Frederick Keuthen (together referred to here as Manufacturers), corporate and individual indenture trustees under the New Haven's First and Refunding Mortgage. The Reorganization Court passed on Manufacturer's petition along with others after new legislation limited Interstate Commerce Commission jurisdiction over such petitions (A486-7). The issue is raised by cross appeals taken by the successor indenture trustee under the New Haven's First and Refunding Mortgage and the successor indenture trustee for the New Haven's General Income Mortgage Bonds. Appellees are Manufacturers and the New Haven trustee, Richard Joyce Smith.

Since July 7, 1961, the New Haven has been in reorganization pursuant to §77 of the Bankruptcy Act, 11 U.S.C. §205, with Judge Anderson constituting the Reorganization Court. On December 31, 1968, the transportation plant of the New Haven was conveyed to Penn Central Transportation Company (Penn Central) in order to keep the transportation system of the New Haven Railroad in operation to avoid devasting economic consequences to southern New England (A492; A584).[1]

With respect to the compensation for the New Haven transportation plant conveyed to Penn Central, the New Haven trustees tentatively agreed with Penn Central on a price of approximately $125,000,000, but that price was not the final price set for the New Haven assets. On June 29, 1970, in the New Haven Inclusion Cases, 399 U.S. 392 (1970), the Supreme Court determined the total consideration to be paid by Penn Central for the assets transferred on December 31, 1968 aggregated $174,635,899 (A584).[2] The current

1. References to the numbered pages of the Joint Appendix are designated "(A...)."
2. This amount includes a loss sharing provision in the amount of $5,000,000.00 (A584).

statement of the New Haven lists the balance due as $121,959,605.02 (A582). The Reorganization Court explained the circumstances by which the total consideration was determined:

> "'A tentative agreement was ultimately reached, in the amount of approximately $125,000,000, which the reorganization court authorized the Trustees of the New Haven to submit to the Commission on October 24, 1966 and which was subsequently approved by the Commission; but it was never submitted to the reorganization court.
>
> "'Thereafter in the proceedings, the Trustees for the New Haven felt that, having made the tentative agreement, there would be some impropriety in their going back to the Railroads, which merged on February 1, 1968 as the Penn Central, to attempt to get a higher price. The court considered their position to be understandable and proper. See New Haven Inclusion Cases, 399 U.S. 392, 410 notes 45 and 46 (1970). The petitioners, however, were not bound by the agreement and, using the $125,000,000 of the agreement as a point of departure, they pressed for a higher price. Ultimately it was fixed by the courts at approximately $174,600,000.'" (A494.)

On June 21, 1970, prior to payment of the total consideration from Penn Central to the New Haven, Penn Central filed its petition for reorganization under §77 of the Bankruptcy Act. From the time of the filing of the Penn Central petition until this time, Manufacturers, through separate counsel, has been in conflict with and acted against the interest of the New Haven estate, from which it sought and was awarded payment for compensation and expenses (A576).

Judge Anderson set forth the nature of the conflict:

> "As far as services of the Manufacturers Hanover Trust Company as indenture trustee are concerned, the court would, on careful review, ordinarily

find that there was sufficient unchallenged and competent evidence to qualify them as legitimate charges except for the fact that, subsequent to the Penn Central's filing of its petition in reorganization while the Manufacturers Hanover Trust Company was acting as indenture trustee for the New Haven's First and Refunding Mortgage (from which position it resigned on June 21, 1971), it was required as indenture trustee for New York Central and/or Pennsylvania Railroad bonds to take certain actions against the interests of the estate of the New Haven Railroad in bankruptcy and did so. The circumstances were described in this court's opinion and order of August 20, 1975 in this case, which are repeated as follows:

"'It appears that Manufacturers, as indenture trustee for the New Haven's First and Refunding Mortgage, was on December 31, 1968 also indenture trustee for 18 mortgages of the New York Central and/or the Pennsylvania Railroads then merged into the Penn Central Transportation Company. This circumstance produced no conflicts between the interests of the various bondholders until after the Penn Central filed its application for reorganization on June 21, 1970 and after the Supreme Court decision in the New Haven Inclusion Cases on June 29, 1970. In August, 1970 the New Haven reorganization court called for statements of position by the parties in interest relative to the remand ordered by the Supreme Court in the Inclusion Cases. There arose at that time an important issue in which the Manufacturers, as indenture trustee for the New Haven's First and Refunding Mortgage and represented by the Simpson, Thacher firm of attorneys, was sharply at odds with the Manufacturers, as indenture trustee of the New York Central and Hudson River Railroad Company Gold Bond mortgage [in which capacity the same trust company was] represented by the Kelley, Drye firm of attorneys. On June 21, 1971 Manufacturers resigned as indenture trustee for the First and Refunding Mortgage of the New Haven. As recently as July 21, 1975, the Manufacturers sought leave of the United States District Court for the Eastern District of Pennsylvania to resign as indenture trustee for

New York Central and Hudson River Railroad Company Gold Bond mortgage dated June 1, 1897, because of potential conflict with its former position as indenture trustee for the New Haven mortgage. So far as is known, Manufacturers continues to act as indenture trustee for the 17 remaining mortgages....'

"The Manufacturers Hanover's petition to the Penn Central reorganization court to resign as indenture trustee for the New York Central and Hudson River Railroad Company Gold Bond Mortgage, dated June 1, 1897, was granted by the Penn Central reorganization court. It is undisputed that Manufacturers Hanover Trust Company is continuing to act as indenture trustee for each of the several bond issues of the New York Central and/or Pennsylvania Railroads which have interests contrary to those of the estate of the New Haven Railroad in reorganization. Moreover, the Manufacturers Hanover Trust Company, as indenture trustee of the New York Central and/or Pennsylvania Railroad bond issues, is of the opinion that it still has a duty to assert, on behalf of the bondholders of those issues, claims contrary to the interests of the New Haven estate, so long as it is in the interests of and the desire of the New York Central and/or Pennsylvania Railroad bondholders to do so.

"The court finds that after the filing by the Penn Central of its petition for reorganization on June 21, 1970 and the filing of the judgment of the Supreme Court in the Inclusion Cases on June 29, 1970, the Manufacturers Hanover Trust Company, as indenture trustee for the New Haven Railroad's first mortgage bonds for nearly 25 years, 1941-1971, faced a conflict of interest with its position as indenture trustee for the New York Central and Hudson River Railroad Company Gold Bond Mortgage as well as it did with its position as indenture trustee for the 17 other New York Central and/or Pennsylvania Railroad bond issues. This was dramatized by the successful action which Manufacturers Hanover, as indenture trustee for the Gold Bonds, brought, through the attorneys for its trust department,

Kelley, Drye, Warren, Clark, Carr & Ellis, against the New Haven reorganization trustee on the ground that the New Haven reorganization court lacked jurisdiction, on remand of the Inclusion Cases by the Supreme Court, to pass upon the secured status of the New Haven's claim for payment for the New Haven's sale and transfer of its operating property.'" (A507-510.) (Emphasis added.)

At that hearing following the Supreme Court's remand in 1970, referred to by Judge Anderson, one of the most important issues was whether the court should order an equitable lien or otherwise subject the assets conveyed to Penn Central to a security interest in favor of the New Haven estate. The New Haven Trustee's position was that the court should declare the existence, since December 31, 1968, of an equitable lien and constructive trust. The New Haven trustee was supported in this position by Manufacturers, as indenture trustee for the New Haven's First and Refunding Mortgage and represented by the Simpson, Thacher and Bartlett firm of attorneys who filed supporting statements of position (A27). Another sharply contested issue at that time on which Manufacturers, as indenture trustee under the New Haven's First and Refunding Mortgage, supported the New Haven Trustee concerned the New Haven's rights to the income from the Grand Central Terminal Properties.

However, at the same time, Manufacturers, as indenture trustee under the New York Central Gold Bond Mortgage, filed an opposing statement through the Kelley, Drye, Warren, Clark, Carr and Ellis firm of attorneys which stated that Manufacturers

> "considers that this Court cannot, and ought not, order an equitable lien or in any way encumber the assets conveyed to the Penn Central Transportation Company ('Penn Central') on December 31, 1968 and cannot, and ought not, order the Trustees of Penn Central to pay the New Haven Trustee or any other person any income from the Grand Central Terminal properties or any income or other proceeds derived from any of the assets of Penn Central for reasons hereinafter discussed." (A30-31.)

The very heading of the response to these issues filed in the Reorganization Court by Manufacturers as indenture trustee under the New Haven's First and Refunding Mortgage illuminates the conflict:

> "RESPONSE OF MANUFACTURERS HANOVER TRUST COMPANY, AS TRUSTEE OF THE FIRST AND REFUNDING MORTGAGE OF THE NEW YORK, NEW HAVEN AND HARTFORD RAILROAD COMPANY, DEBTOR, TO THE STATEMENTS OF POSITION FILED BY THE INTERSTATE COMMERCE COMMISSION, MANUFACTURERS HANOVER TRUST COMPANY, AS TRUSTEE UNDER THE NEW YORK CENTRAL AND HUDSON RIVER RAILROAD COMPANY GOLD BOND MORTGAGE OF 1897, AND THE REORGANIZATION TRUSTEES OF PENN CENTRAL TRANSPORTATION COMPANY." (A36.)

Referring to the 1970 hearing following the Supreme Court's remand, Judge Anderson said:

> "The startling result was that, on opening court one morning, the New Haven reorganization court was handed a brief by the Simpson, Thacher firm from Manufacturers Hanover Trust Company for the New Haven side of the case, and it was then handed another brief by the Kelley, Drye firm from the Manufacturers Hanover Trust Company for the other side of the same case." (A512.)

The Reorganization Court's decision imposing the equitable lien and constructive trust in favor of the New Haven estate issued on June 11, 1971. Acting through the Kelley, Drye firm, Manufacturers, together with the Penn Central Trustees, appealed to the Court of Appeals for the Second Circuit (A100). Once

again Manufacturers was on both sides of the issues, but this time it was its alliance with the Penn Central trustees which proved successful, not only in securing in this Court a reversal of the Reorganization Court's decision, but also in its efforts to have the New Haven trustee's petition to the Supreme Court of the United States for certiorari denied. In re New York, New Haven and Hartford Railroad Company, 457 F.2d 683 (2 Cir.), cert. denied, 409 U.S. 890 (1972).

Commenting on Manufacturers' failure to resign its Penn Central fiduciary position and recognizing the complexities facing Manufacturers as fiduciary in the Penn Central reorganization, Judge Anderson held:

> "Nevertheless, the prospect of more problems superimposed upon already existing ones of immense difficulty cannot operate to condone breach of fiduciary duty or justify it...."
>
> "Manufacturers Hanover should have resigned from both, as its Chairman had said, but apparently no one felt the necessity of following through on his admonition..." (A511-512.)

Instead of resigning from both estates, Manufacturers--as the testimony of Robert A. Byrne, the Vice President whom Manufacturers presented to justify its petition for payment indicated--attempted to insulate itself from its conflicts problems by maintaining separate counsel for its conflicting interests: Simpson, Thacher and Bartlett to represent Manufacturers as indenture trustee under the New Haven's First and Refunding Mortgage and the Kelley, Drye firm to represent Manufacturers as indenture trustee under the New York Central

Gold Bond Mortgage and other Penn Central bonds (A375). Mr. Byrne never really answered the Reorganization Court's question:

> "How do you work that and not let your right hand know what your left hand is doing? Do you often do that?" (A377.)

The official's reply indicated that Manufacturers did not get into the conflict situation "voluntarily", and that "we did the best we could to insulate any possibility of a conflict by having separate representation..." (A377.)

As to the Manufacturers' insulation theory, it was developed on the advice of counsel from both Simpson, Thacher and Bartlett and Kelley, Drye (A394-395). The two sets of lawyers, moreover, reported to the same officials at Manufacturers (A391). The insulation theory was approved neither by the New Haven Reorganization Court nor by the Penn Central Reorganization Court (A391). Manufacturers never petitioned either the New Haven Reorganization Court or the Penn Central Reorganization Court with regard to the appointment of a guardian ad litem, substitute trustees, or, for that matter, any advice or instructions concerning its conflicting situation (A387-389). The conflicts issue was never taken up with the New Haven Reorganization Court at all (A388).

Finally, Mr. Byrne stated that Manufacturers would have a moral obligation to pay Simpson, Thacher and Bartlett in the event that the Reorganization Court did not award counsel fees out of the New Haven estate. When the court below asked,

"You would what, have the obligation or would pay them?"

Mr. Byrne replied,

"We would pay them." (A398).

Although the Penn Central filed its reorganization petition on June 21, 1970, it was not until one year later, June 21, 1971, that Manufacturers filed its petition in the New Haven Reorganization Court to resign due to its conflicts of interest (A93). Not only did Manufacturers face conflicts regarding the Gold Bond Mortgage, but as its petition to resign indicates, Manufacturers is also a creditor of Penn Central. It is one of several bank participants in a $300 million loan to Penn Central under the April 1, 1969 Credit Agreement and one of the banks that loaned $50 million to Pennsylvania Company, a subsidiary of Penn Central, under the March 21, 1970 Credit Agreement. It is also the holder of certain equipment obligations of Penn Central subsidiaries (A93-94).

On September 4, 1975, Manufacturers' resignation, as indenture trustee for the New York Gold Bond Mortgage, was accepted by the Penn Central Reorganization Court (A510), but it is undisputed that Manufacturers is continuing to act as indenture trustee for several bond issues of the New York Central and/or Pennsylvania Railroads which have interests contrary to those of the estate of the New Haven (A509). Moreover, Manufacturers, as indenture trustee of the New York Central and/or Pennsylvania Railroad bond issues, is of the opinion that it still has a duty to assert, on behalf of the bondholders of those issues, claims contrary to the interests of the New Haven estate, so long as it is in the interests of and the desire of the New York Central and/or Pennsylvania Railroad bondholders to do so (A509).

Ruling on Manufacturers' petition to clarify its opinion, the Reorganization Court once again found that Manufacturers

> "plainly breached its fiduciary duty to the New Haven Railroad in reorganization and for five years has continued to do so." (A576.)

The Court added that Manufacturers

> "has expressly stated its intention to adhere to this position in the future and to oppose and contest the claim of the New Haven estate in reorganization that the purchase price due for the New Haven's property, based upon the Supreme Court's judgment against the Penn Central in the Inclusion Cases, is secured by an equitable lien. For the past three years, at least, Manufacturers has made no genuine effort to resign as Indenture Trustees for the remaining 17 bond issues for which it is still Indenture Trustee...." (A576.)

Until February 5, 1976, when the Railroad Revitalization and Regulatory Reform Act of 1976 (Public Law #94-210) (Rail Act) became effective, the Reorganization Court and the Interstate Commerce Commission (I.C.C.) shared responsibility for acting upon compensation and reimbursement requests submitted by parties to the reorganization (A486). After the effective date of the Rail Act, which, inter alia, provided that the powers and duties of the I.C.C. with respect to fee and reimbursement applications vested with the Reorganization Court (A486-487), Manufacturers and others filed their claims for compensation for services and allowances of costs (A487-488). Manufacturers' claim, incurred from July 7, 1961 to August 30, 1971, was as follows (A488):

1.	Compensation to Manufacturers	$304,416.67
2.	Expenses of Manufacturers	103,018.34
		$407,435.01
3.	Legal fees of Simpson, Thacher and Bartlett	1,700,000.00
4.	Disbursements of Simpson, Thacher and Bartlett	15,234.81
		$1,715,234.81
		$2,122,669.82

In passing on this claim the Reorganization Court first discussed Manufacturers' direct claim for services and expenses, as distinguished from its claim for attorneys' fees. The court below allowed the expenses of $103,018.34 and treated its direct compensation request on a contingent basis, ruling:

> "The Trust Company's claim for services rendered in the amount of $304,416.67, or any recoverable part of it, is ordered to be treated as contingent. The Manufacturers Hanover Trust Company is ordered to accept in full accord and satisfaction of the claimed sum and any and all claims for services, rendered by it as indenture trustee for the New Haven's First and Refunding Mortgage in any manner whatsoever, one-quarter (1/4) of one per cent. (1%) of all payments made on and after the date of this judgment, to the New Haven estate in reorganization, for and on account of the purchase price, to be paid by the Penn Central for properties of the New Haven, as fixed by the judgment of the Supreme Court in the Inclusion Cases. Said payment of 1/4 of 1% to the Manufacturers Hanover Trust Company shall in no event exceed $304,416.67 and no interest or other increments shall be added to this sum. In the event that the Manufacturers Hanover Trust Company declines so to accept whatever may accrue to it under the foregoing computation, the Trust Company's claim for services against the New Haven estate shall be disallowed in toto." (A515.)

Although he recognized that the prime authority on allowances, Woods v. City National Bank and Trust Company of Chicago, 312 U.S. 262 (1941), "authorized a complete disallowance of fees for services and reimbursement of expenses..." (emphasis added) (A514), Judge Anderson isolated Manufacturers' claim as to Simpson, Thacher and Bartlett from its direct claim and awarded "$808,000, plus such contingent addition as may later eventuate in accordance with a provision hereinafter recited" (A520).

As to the contingent aspect, the court ruled:

> "It is, therefore, further ordered that in the event that there is a future recovery by the reorganization trustee of the New Haven Railroad of payments by the Penn Central or its successors or assigns, on account of the purchase price fixed by the Supreme Court for the New Haven properties in the New Haven Inclusion Cases, the reorganization trustee or his successor or successors shall pay to:
>
> "(1) MANUFACTURERS HANOVER TRUST COMPANY for and on account of the services of its attorneys Simpson, Thacher and Bartlett, 1/4 of 1% of such payment or payments;..." (A524-525.)

The expenses approved by the Reorganization Court totaling $103,081.34 consist of the following:

Court transcripts	$ 14,814.97
Printing bills for:	
(a) Reports to Bondholders	2,005.84
(b) Briefs and appendices	43,080.90
(c) Publication of notice	396.64

Travel expenses between New York and New Haven and New York and Washington, D.C.	945.37	
Portion of expenses shared with Chase Manhattan Bank as Trustee for services of Wyer, Dick & Co., S.D. Leidesdorf & Co., and G.L. & H.J. Gross Inc.	41,470.19	
Portion of expense in various I.C.C. proceedings paid to Dewey, Ballantine, Bushby, Palmer & Wood	202.20	
Unbilled and unpaid advances	102.23	
Total	$103,018.34	(A157; A507.)

The amount awarded Manufacturers by the Reorganization Court does not include any compensation for normal services rendered by Manufacturers--those services which Manufacturers would have rendered as indenture trustee if there had been no default by the New Haven. As Manufacturers states:

> "In this connection it is to be noted that for their Normal Services during the period July 7, 1961 to the date they ceased to act as Trustee under the Mortgage, Petitioners have been paid the sum of $43,937.24 by the Trustees of the Debtor." (A136.)

The total definite award to Manufacturers is:

1.	Expenses of Manufacturers	$103,018.34
2.	Legal fees of Simpson, Thacher and Bartlett	808,000.00
3.	Expenses for Simpson, Thacher and Bartlett	15,234.81
	Definite Award	$926,253.15

which potentially can be increased by the contingency factor as follows:

4.	Contingency to Manufacturers	$304,416.67
5.	Contingency to Simpson, Thacher and Bartlett	304,899.01
	Contingent Award	$609,315.68
	Total Award	$1,535,568.83

On this record, appellant Successor Trustees urge this Court to reverse the Reorganization Court's order insofar as it awarded any compensation or reimbursement of expenses at all to Manufacturers.

Argument

MANUFACTURERS, A FORMER INDENTURE TRUSTEE UNDER THE MORTGAGE OF THE DEBTOR RAILROAD, AS A CLAIMANT UNDER §77(c)(12) OF THE BANKRUPTCY ACT, CANNOT RECOVER PAYMENTS FOR COMPENSATION, EXPENSES AND ATTORNEYS' FEES FROM THE DEBTOR'S ESTATE WITH WHICH IT WAS AND REMAINS IN CONFLICT BY ACTIVELY PURSUING INTERESTS ADVERSE TO THE ESTATE ON THE CENTRAL ISSUE OF THE REORGANIZATION.

While it continues to occupy fiduciary positions in conflict with the New Haven estate on an issue at the heart of the reorganization of the New Haven, Manufacturers has been awarded a direct payment of $926,253.15 plus a contingent payment of up to $609,315.68 as an indenture trustee of the New Haven estate. If Manufacturers is successful in the hostile position advanced as a fiduciary in the Penn Central reorganization the New Haven will lose a secured position with respect to its $121,959,605.02 balance due for the assets conveyed to the Penn Central (A582), so as to virtually eliminate the New Haven's ability to honor its obligations to bondholders (A583).

In an effort to escape the impact of Woods v. City National Bank & Trust Company of Chicago, 312 U.S. 262 (1941)--the leading case in the area--Manufacturers advised the Reorganization Court that Manufacturers never "'pursued any interest adverse to the estate.'" (A513). Recognizing the inaccuracy of this claim, the Reorganization Court found that Manufacturers

> "has 'pursued [an] interest adverse to the New Haven estate' in pursuing the interests of the 18 New York Central and/or Pennsylvania Railroad indentures and it declares it has a duty to continue to do so. That is precisely what it has been doing over the past five years, and the Woods case declares it to be a breach of fiduciary duty. The law does not countenance such activity by a fiduciary--even an indenture trustee. Woods v. City National Bank & Trust Company of Chicago, supra; In re Boston & Providence Corp., supra, 260 F.Supp. at 422." (A513).

In awarding payments to Manufacturers, notwithstanding recognition of the breach of fiduciary duty which the "law does not countenance", the court below diluted the Supreme Court's "inflexible rule of denying compensation to creditors' representatives serving conflicting interests" established in Woods. Note, Denial of Compensation to Bondholders' Representatives Serving Conflicting Interests in Corporate Reorganization. 50 Yale L.J. 1492, 1493 (1941). The action of the court below, as a matter of law, can only encourage Manufacturers to maintain its fiduciary positions in the Penn Central estate and attempt to thwart the New Haven's effort to collect the $121,959,605.02 balance due from the Penn Central estate to meet its obligations to its bondholders.

The position which the Successor Trustees urge this Court to recognize is that a claimant, such as Manufacturers, cannot be in a position of impeding the reorganization, as it clearly is, while at the same time receiving from the debtor's estate payment for compensation or expenses of the type recovered here, even if such services and expenses, for which payment was sought and made, in themselves did not impede the reorganization.

In Woods, claims for compensation during proceedings under Chapter X were filed against the debtor by an indenture trustee, the members of a bondholders' committee and the committee's counsel, who was also counsel to the indenture trustee and whose services in the latter capacity were included in the claim of the indenture trustee. Finding the claims for compensation void "for want of equity", 312 U.S. at 264, on the grounds that the claimants were serving conflicting interests, the reorganization court refused to allow any compensation out of the debtor's estate. The Seventh Circuit overruled this decree, but was in turn reversed by the Supreme Court. Adopting a strict rule in order to foreclose the "tendency to evil" implicit in such cases, 312 U.S. at 268, the Court held that neither the indenture trustee--a fiduciary serving interests conflicting with those of his cestui--nor his counsel were entitled to receive compensation for their services, regardless of their good faith. 312 U.S. at 270.

> 1. "'[R]easonable compensation for services rendered' necessarily implies loyal and disinterested service in the interest of those for whom the claimant purported to act." 312 U.S. at 268. (Emphasis added.)
>
> 2. "Where a claimant who represented members of the investing public, was serving more than one master or was subject to conflicting interests, he should be denied compensation. It is no answer to say that fraud or unfairness were not shown to have resulted. Cf. Jackson v. Smith, 254 U.S. 586, 589. The principle enunciated by Chief Justice Taft in a case involving a contract to split fees in violation

of the bankruptcy rules, is apposite here: 'What is struck at in the refusal to enforce contracts of this kind is not only actual evil results but their tendency to evil in other cases.' Weil v. Neary, 278 U.S. 160, 173. Furthermore, the incidence of a particular conflict of interest can seldom be measured with any degree of certainty." 312 U.S. at 268. (Emphasis added.)

3. "Where an actual conflict of interest exists, no more need be shown in this type of case to support a denial of compensation." 312 U.S. at 268. (Emphasis added.)

4. "A fiduciary who represents security holders in a reorganization may not perfect his claim to compensation by insisting that although he had conflicting interests, he served his several masters equally well or that his primary loyalty was not weakened by the pull of his secondary one." 312 U.S. at 269. (Emphasis added.)

5. "Only strict adherence to these equitable principles can keep the standard of conduct for fiduciaries 'at a level higher than that trodden by the crowd.'" 312 U.S. at 269. (Emphasis added.)

In the case at bar, Manufacturers is not "disinterested", serves "more than one master", and has an "actual conflict of interest". Certainly "no more need be shown" than is on this record to revoke the award made to Manufacturers by the Reorganization Court for its own compensation, its attorneys' compensation and its expenses. As the Supreme Court in a related context has forthrightly stated since Woods:

"Moreover, it is well settled that when the question arises in a terminal application for compensation or reimbursement under §247, an applicant who has engaged in forbidden transactions near the end of the proceeding is to be denied compensation for all services he has rendered to the Debtor, however valuable those services may have been." Wolf v. Weinstein, 372 U.S. 633, 654 (1963).

As noted, the $1,535,568.83 direct and contingent award to Manufacturers included the contingency payment to Manufacturers for services, payment to Manufacturers for reimbursement of its expenses and payment to Manufacturers for its attorneys' fees and its attorneys' expenses. The total award, the Successor Trustees urge, should be vacated.

A. As To The Contingency Payment To Manufacturers For Its Own Services.

The contingency award to Manufacturers for its own, direct services violates the clear command of the Supreme Court in Woods and Wolf. To justify the contingent award to Manufacturers, the court below relied upon two decisions of this Court which it felt "tempered" the strict rule of Woods:

> "While Woods v. City National Bank & Trust Company of Chicago, supra, authorized a complete disallowance of fees for services and reimbursement of expenses, later cases in this Circuit and others have tempered this somewhat. See, Berner v. Equitable Office Building Corp., 175 F.2d 218 (2 Cir. 1949); Silbiger v. Prudence Bonds Corp., 180 F.2d 917 (2 Cir.), cert. denied 340 U.S. 813 (1950); Chicago & West Towns Rys. v. Friedman, 230 F.2d 364 (7 Cir.), cert. denied 351 U.S. 943 (1956)." (A514).

But Berner and Silbiger do not justify modifying the Woods-Wolf rule in this situation. In Silbiger, this Court noted that the "usual consequence" of the conflict of loyalties is an absolute prohibition and "a forfeiture of all pay", 180 F.2d at 920-921, but allowed a modification

> "in a corporate reorganization proceeding [where] it is reasonable not to impose an entire forfeiture of the allowance, when it comes in no part out of any group that can have been prejudiced by the attorney's divided allegiance." 180 F.2d at 921 (Emphasis added).

Since the award was paid from the bond series which was fully compensated in the reorganization, this Court considered that the attorney's allowance should only be reduced, not denied. In the case at bar, it cannot be said that payment to Manufacturers will come in no part out of any group that can be prejudiced, since the payment will necessarily diminish the funds available to meet the New Haven estate's obligations to the holders of its general income bonds and may diminish the payment to its first mortgage bondholders. Berner was based on a breach of trust only to the shareholders from whom certain stock was purchased. 175 F.2d at 222. Here, Manufacturers' breach is to the entire New Haven estate which, in its attempts to realize the $121,959,605.02 secured by the equitable lien, is now an adversary of Manufacturers. And Friedman, the Seventh Circuit case cited by the Reorganization Court, relied solely on this Court's decisions in Silbiger and Berner to dilute Woods. Since, as shown, Silbiger and Berner cannot be so utilized, the underpinnings of Friedman have been removed. Moreover, all three of the cases cited by the Reorganization Court predated the Supreme Court's pronouncements in Wolf. Insofar as Wolf held that, as a matter of law, a fiduciary with a conflict of interest "forfeits any claim to reimbursement for expenses" as well as compensation, 372 U.S. at 653 n. 20, it casts grave doubt on the continuing validity of the proposition enunciated in Berner, Silbiger and Friedman, that this is an area for the exercise of discretion. Indeed, this Court has recognized that the discretionary approach of Berner may no longer be the law of this circuit. Surface Transit, Inc. v. Saxe, Bacon & O'Shea, 266 F.2d 862, 868 (2 Cir. 1959).

If the contingency award to Manufacturers is allowed to stand in dilution of the Woods-Wolf doctrine, it will "frustrate" an

"effective propnylactic rule," Wolf v. Weinstein, supra, 372 U.S. at 655, established by the Supreme Court. It is of no moment that many of Manufacturers' services were performed before the conflict became ripe. As the Supreme Court said, while interpreting the insider trading prohibition of §249 of the Bankruptcy Act, 11 U.S.C. §649:

> "Thus the policies of the statute afford no alternative but to order the restitution of all amounts of compensation and reimbursement received by these respondents since the start of the reorganization." 372 U.S. at 654. (Emphasis added.)

B. As To The Payment To Manufacturers For Its Direct Expenses.

To be sure, in Woods, the Court did state that reimbursement for "proper costs and expenses incurred in connection with the administration" of the estate may or may not be allowed, referring to §242 of the Bankruptcy Act, 11 U.S.C. §642. The Court said:

> "The rule disallowing compensation because of conflicting interests may be equally effective to bar recovery of the expenditures made by a claimant subject to conflicting interests. Plainly, expenditures are not 'proper' within the meaning of the Act where the claimant cannot show that they were made in furtherance of a project exclusively devoted to the interests of those whom the claimant purported to represent. On the other hand, those expenditures normally should be allowed which have clearly benefited the estate. Scott, Trusts (1939), §245. Thus, where taxes have been paid, needful repairs or additions to the property have been made, or the like, equity does not permit the estate to retain those benefits without paying for them. Such classification of expenses, at times difficult, rests in the sound discretion of the bankruptcy court." 312 U.S. at 269-270.

The $103,018.34 awarded as repayment for Manufacturers' expenses is arguably the type of expense, the classification of which is within the "sound discretion of the bankruptcy court."

312 U.S. at 269-270. These expenses, however, are hardly akin to the taxes, needful repairs or additions to the property referred to in Woods. The type of expenses, probably referred to in Woods, are the normal indenture trustee expenses, here amounting to $43,937.24, which have already been paid by the debtor to Manufacturers (A136), and are not challenged here. The court below cited no authority for the payment of Manufacturers' expenses, but noted there "has been no objection to them." (A514.) Insofar as the Reorganization Court's action as to the $103,018.34 was based on its assertion that "none of the items has been contested" (A507), its reversal is sought also, for in the court below the successor trustee for the income bonds argued:

> "Under the doctrine in Woods v. City National Bank and Trust Company, 312 U.S. 262 (1941), the petition of Manufacturers for itself and its lawyers should be denied in toto because of Manufacturers' conflicts of interest." (A444.)

Moreover, in Wolf, the Supreme Court appears to have called for a stronger rule as to the payment for expenses of disqualified fiduciaries:

> "...[P]roof of trading in violation of §249 forfeits any claim to reimbursement for expenses incurred by the applicant in connection with the proceeding." 372 U.S. at 653 n. 20.

C. As To The Payment To Manufacturers For Its Attorneys.

Without citing any authority (A515-519), the Reorganization Court awarded Manufacturers $823,234.81 plus a contingency of up to $304,899.01, or a total of $1,128,133.82, for its attorneys. The court made it clear that the contingency award for Manufacturers' attorneys was for reasons unrelated to Manufacturers' breach of

trust (A516). This Court cannot permit this award to stand without establishing, as a rule of law, that a fiduciary--tainted by conflict--can recover attorneys' fees even after hiring separate attorneys to advocate diametrically opposed positions on the issue most seriously affecting the reorganization. Such a rule of law, it is submitted, would run afoul of controlling Supreme Court precedent.

As noted, Woods speaks of certain expenses over which a reorganization court may exercise discretion. 312 U.S. at 269-270. But certainly attorneys' fees are not expenses, the classification of which is "within the sound discretion of the bankruptcy court", within the meaning of Woods, 312 U.S. at 270. The Supreme Court was not remotely considering attorneys' fees when it discussed "taxes...needful repairs...or additions to the property." 312 U.S. at 270. In Woods, the indenture trustee's claim included a claim for attorneys' fees which was forthrightly denied without remanding for a discretionary classification as to whether it was an expense. To be sure, that action is consistent with the fact that the attorneys themselves had a conflict of interest aside from that of their indenture trustee client, but nowhere does the Court suggest that a tainted fiduciary can recover attorneys' fees for his counsel by labeling his claim "reimbursement for proper costs and expenses incurred" within the meaning of §242, the

statute involved in Woods.[3]

The equitable principle in Woods evolved from the Court's consideration of compensation to an indenture trustee, not reimbursement of expenses. While the statutory language of §77(c)(12), 11 U.S.C. §205(c)(12), is not precisely the same as that of §242, 11 U.S.C. §642, the strict rules regarding conflicts established in Woods and Wolf govern Manufacturers' application. Under §242, the attorneys for the indenture trustee could have made their own claim for compensation for services plus expenditures directly to the court. Under §77(c)(12), involved here, however, the claimant

3. That the Supreme Court was not remotely considering compensation for services rendered by attorneys within the "proper costs and expenses incurred in connection with the administration" of the estate, is manifest when the statute it was dealing with is read in its entirety. Section 242 of the Bankruptcy Act, 11 U.S.C. §642, provides:

> "The judge may allow reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred in connection with the administration of an estate in a proceeding under this chapter or in connection with a plan approved by the judge, whether or not accepted by creditors and stockholders or finally confirmed by the judge--
> (1) by indenture trustees, depositaries, reorganization managers, and committees or representatives of creditors or stockholders;
> (2) by any other parties in interest except the Securities and Exchange Commission; and
> (3) by the attorneys or agents for any of the foregoing except the Securities and Exchange Commission."

If compensation for attorneys' services were included within reimbursement for "proper costs and expenses incurred in connection with the administration" of the estate, the statute would be redundant. There would be no need for subsection (3) of §242 which expressly provides that the attorneys themselves may make a direct claim to the court for reasonable compensation for services rendered and reimbursement for proper costs and expenses.

must be the indenture trustee, and the claimant, under Woods, must be pure. As the later Wolf case demonstrates:

> "[T]he rationale underlying the denial of compensation and expenses is that allowances may be made, under general equitable limitations and the statutory provisions alike, only for 'loyal and disinterested service in the interest of those for whom the claimant purported to act.' Woods v. City Nat. Bank & T. Co., supra (312 US at 268). Section 249 does no more than declare that one who invests in the Debtor's stock during a reorganization ceases to be disinterested for purposes of compensation and allowances." 372 U.S. at 653 n. 20. (Emphasis added.)

Attorneys' fees, then, cannot come from the estate where the claimant is not disinterested.

The principle that equity will not allow compensation from the estate for services rendered on behalf of the indenture trustee to attorneys, who are not themselves in conflict but who nevertheless serve an indenture trustee with interests in conflict with its bondholders, was applied in In re Ritz Carlton Restaurant & Hotel Co. of Atlantic City, 60 F.Supp. 861 (N.J. 1945). The court there invoked the inflexible rule derived from Woods: that there can be no recovery of attorneys' fees for fiduciaries who do not possess the independence necessary for their duties. During the reorganization proceedings in Ritz Carlton, the indenture trustee, Nestel, had been removed because he was too closely allied with the bondholders committee to act independently. No dishonesty of any sort was attributed to Nestel, but the court, having found him not to be a disinterested trustee, applied the strict rule of Woods and disallowed his petition for compensation. As to his attorneys' petition for compensation, the court ruled:

"The same reason for the disallowance of the petition for services rendered by the Committee and Walter Nestel applies to the application of the attorneys for this Indenture Trustee, and their petition for an allowance will likewise be disallowed." 60 F.Supp. at 867.

By allowing compensation to an attorney who served both Nestel, the tainted trustee, and the untainted successor indenture trustee who replaced Nestel, the court decreed that an attorney for a fiduciary who is denied recovery is likewise denied recovery:

"The last mentioned litigation was in defense of the position of Indenture Trustee Nestel heretofore discussed and in which he was replaced by the late Alexander L. Rogers as Successor Indenture Trustee. We have heretofore enlarged upon the proposition that services in behalf of Indenture Trustee Nestel are not, in our judgment, compensable. The petitioner may be compensated only for its services to the Successor Indenture Trustee Rogers, and therefore an allowance limited to the sum of $500 will be granted." 60 F.Supp. at 867.

Manufacturers' arguments to the court below that the facts of Woods differ from those in the case at bar and that no improper conduct by Simpson, Thacher and Bartlett is alleged or proved, is similar to that proferred by counsel in In re American Acoustics, Inc., 97 F.Supp. 586, 589 (N.J.), affirmed, 192 F.2d 81 (3 Cir. 1951) (per curiam), where the court nevertheless applied the "general principles" of Woods and In re Ritz Carlton Restaurant Co., supra, to invoke a strict rule denying compensation to attorneys who represented adverse interests.

No issue is raised with the statement of the court below that:

"Too much, of course, should not be read into or inferred from such phrases as 'breach of fiduciary trust' or 'disqualified...as indenture trustee'.

> Such descriptive words do not say or imply that the Trust Company indulged in any conduct of a criminal nature or sought in any way to take or use other persons' property for its own use, or otherwise acquire any personal gain for itself. The Manufacturers Hanover Trust Company, through no action of its own, found itself in a position between conflicting interests, as to each of which it was in a position of indenture trustee. It could not help one without hurting the other." (A513.)

However, although Manufacturers found itself in a conflict "through no action of its own", it failed to take appropriate remedial steps. Manufacturers' statement to the court below that, "[w]hen the conflict arose, Manufacturers, rather than concealing the fact, moved promptly to disclose its existence, and sought relief," (A481), is inaccurate. It was not until one year after the Penn Central defaulted and the conflict became manifest, that Manufacturers moved to resign from its New Haven interests (A508). It was not until 1975 that Manufacturers resigned as indenture trustee for the Gold Bond Mortgage in the Penn Central reorganization court. And, Manufacturers is still acting as indenture trustee for the other Penn Central mortgages and is still actively pursuing interests contrary to those of the New Haven estate (A509). Clearly, Manufacturers, as a trustee, was not compelled to act at its peril, but under trust law was entitled to apply to the Reorganization Court for instructions if it was in doubt as to its duties when the conflict became manifest. Restatement of Trusts 2d §259 (1959); III Scott on Trusts §§201, 259 (3d Ed. 1967).

The Supreme Court in Mosser v. Darrow, 341 U.S. 267 (1951), held the trustee in a reorganization proceeding personally charge-

able with the profits made by his employees in trading in the debtor's securities although the trustee made no personal profits and the trusts suffered no loss, but in fact profited by the employees' buying program. The Court discussed the reason for the strict rule:

> "Equity tolerates in bankruptcy trustees no interest adverse to the trust. This is not because such interests are always corrupt but because they are always corrupting....
>
> "These strict prohibitions would serve little purpose if the trustee were free to authorize others to do what he is forbidden. While there is no charge of it here, it is obvious that this would open up opportunities for devious dealings in the name of others that the trustee could not conduct in his own. The motives of man are too complex for equity to separate in the case of its trustees the motive of acquiring efficient help from motives of favoring help, for any reason at all or from anticipation of counter favors later to come. We think that which the trustee had no right to do he had no right to authorize, and that the transactions were as forbidden for benefit of others as they would have been on behalf of the trustee himself." 341 U.S. at 271-272. (Emphasis added.)

Discussing the ways in which a trustee can protect himself against personal liability, the Court stated:

> "The practice is well established by which trustees seek instructions from the court, given upon notice to creditors and interested parties, as to matters which involve difficult questions of judgment. In this particular matter, it is claimed that the special knowledge of Miss Johnson and Kulp was indispensable to the trustee. This, it is said, is the reason the trustee yielded to their insistence upon the right to speculate in the securities underlying the trust. If their services were so indispensable that an arrangement so highly irregular was of advantage to the trust, this might have been fully disclosed to the court and the creditors cited to show cause why it should not have been openly authorized. Instead of this, the

> trustee, although he did discuss with Judge Holly the employment of Kulp and Miss Johnson, did not disclose the critical fact that he was employing them on terms which permitted their trading in the underlying securities. Indeed, it appears that he did not even disclose this feature of the transaction to his own counsel. It is hardly probable that a candid disclosure to creditors, to the court, and to interested parties would have resulted in instructions to have pursued this course; but, had it been authorized, at least the assenting creditors might have found themselves estopped to question the transaction." 341 U.S. at 274.

The Mosser case is analogous to Manufacturers' situation. Manufacturers hired two counsel to represent its conflicting interests. That which Manufacturers "had no right to do", it "had no right to authorize", and if in doubt about its duty to its cestuis, it should have sought instructions from the Reorganization Court. The trustee in Mosser made "an honest mistake", 341 U.S. at 276 (Black, J., dissenting), and the trust estate profited. Yet the Supreme Court held him personally liable for the profits which his employees made.

If Manufacturers had "sought relief" as it claims it did, the New Haven Reorganization Court would have advised Manufacturers to resign from all of the bond issues in question, i.e. both in the New Haven and in the Penn Central estates (A510). But Manufacturers on its own and with the advice of counsel chose its course of action--a course which the Reorganization Court found was improper.

The quality or nature of the services rendered by Simpson, Thacher & Bartlett is not challenged. The issue here is not whether Simpson, Thacher & Bartlett should be paid, but whether Manufacturers, as a claimant, can be reimbursed from the estate for services performed by Simpson, Thacher & Bartlett.

The statement of the trustee--referred to by the court below--that

> "'...as a practical matter, a reduction in the amount allowed as reimbursement for legal fees is likely to impact persons who, in the trustee's view, have benefited the Estate and as to whom no misconduct has even been intimated'" (A516)

does not comport with the record. Both Manufacturers and Simpson, Thacher & Bartlett represented to the court below that, if the legal fees found to be reasonably and properly reimbursable to Manufacturers out of the assets of the New Haven estate were in Simpson, Thacher & Bartlett's view grossly inadequate,

> "Simpson, Thacher & Bartlett would come to Manufacturers Hanover and ask that they be paid additional compensation out of Manufacturers Hanover's own funds. Manufacturers Hanover agreed to consider any such request but it was expressly understood that it would be under no legal obligation to comply." (A138; A167.)

Although there is no written document governing the Manufacturers - Simpson, Thacher & Bartlett fee arrangement (A396), Manufacturers' vice president told the Reorganization Court that Manufacturers would pay its lawyers:

> "Q Do you agree with the statement that your lawyer just made that you are under a moral obligation to pay them if that occurs?
>
> "A I think we would.
>
> "THE COURT: You would what, have the obligation or would pay them?
>
> "THE WITNESS: We would pay them." (A397-398.)

In the court below, after this testimony was given, Manufacturers argued in its brief that this was merely a "personal

opinion" (A475), but such an assertion ignores the fact that Vice President Byrne was Manufacturers' sole witness produced to justify its position, and was not subjected to further examination by Manufacturers' counsel in order to clarify this point.

Moreover, Simpson, Thacher & Bartlett were not strangers to the arrangement by which the conflict developed and continued:

> "Q One of the points you mentioned on direct to Mr. Bader was that you in setting the fee as you did as trustee, you were concerned with the novelty of the issues involved. I assume, therefore, when you came upon this insulation theory, you consulted counsel on this theory; is that correct?
>
> "A Yes.
>
> "THE COURT: Which counsel?
>
> "THE WITNESS: Well, we have talked to each counsel separately.
>
> "BY MR. ZELDES:
>
> "Q And did they both -- I'm sorry, Your Honor.
>
> "THE COURT: Go ahead.
>
> "Q When you consulted with both of these counsel separately, did they give you the same advice with respect to the insulation theory?
>
> "A It's the best we could do, yes.
>
> "Q But they both gave you the same advice; is that correct?
>
> "A Yes.
>
> "Q Were any of these advices given to you in writing?
>
> "A I would say no. To my knowledge, no." (A394-396.)

In the court below, Manufacturers implied, in response to the trustee's comments at the hearing on the fee application that

it was for someone other than Manufacturers or its lawyers to suggest a cure for the conflict. Said Manufacturers:

> "...the Reorganization Trustee implied at the May hearing that we should perhaps have sought the appointment of a special master - and perhaps special counsel - when the conflict appeared. We would observe that such a course was then suggested by no one." (A476-477.)

This assertion seems to attempt to give to the reorganization trustee a burden more properly on the shoulders of Manufacturers or its lawyers. And the assertion meshes with what Mr. Byrne said at the hearing--that both sets of Manufacturers' lawyers told Manufacturers that under the circumstances, the hiring of two sets of lawyers was "the best we could do." (A395.) Although both Manufacturers and the lawyers recognized the conflict, Manufacturers did not receive advice to resign from both estates, to seek instructions from the reorganization courts involved, or to ask for a guardian ad litem (A388-389), even though the chairman of the board of Manufacturers was of the opinion that Manufacturers should resign from all mortgages in both estates (A382).

The theory that representation on both sides of an issue insulates the fiduciary from liability for breach of a fiduciary obligation or protects the fiduciary from loss of compensation is unsupported by precedent and is dangerous policy. The issue of Simpson Thacher's fee boils down to whether the breaching fiduciary or his cestui and the estate should bear the expense of legal services rendered to the fiduciary. We urge that, under the precedents described above, the fiduciary should bear the cost.

The rationale which gave rise to the Woods rule--where an actual conflict of interest exists, no more need be shown to support a denial of compensation--is equally applicable to this case. As the Supreme Court in Woods explained:

> "The bankruptcy court need not speculate as to whether the result of the conflict was to delay action where speed was essential, to close the record of past transactions where publicity and investigation were needed, to compromise claims by inattention where vigilant assertion was necessary, or otherwise to dilute the undivided loyalty owed to those whom the claimant purported to represent." 312 U.S. at 268.

Manufacturers, the indenture trustee serving conflicting interests, had the ultimate responsibility to its bondholders. Counsel for both sets of bondholders, Simpson, Thacher & Bartlett for the New Haven bondholders and Kelley Drye for the Penn Central bondholders, reported to the same officials at Manufacturers (A391). Control of counsel's actions in the New Haven reorganization as well as in the Penn Central reorganization rested with Manufacturers, which made the ultimate decisions with respect to the position taken by Manufacturers on both sides of the equitable lien issue. Under these circumstances, it would indeed be an exercise in speculation to attempt to evaluate the effect on the New Haven estate as a result of Manufacturers' conflicting interests.

That the Reorganization Court found that Simpson, Thacher & Bartlett rendered valuable service to the New Haven estate does not answer the question of this case. Without the conflict Manufacturers would be entitled to reimbursement for the reasonable value of Simpson, Thacher & Bartlett's fees. But Simpson, Thacher

& Bartlett's efforts to enhance the value of the New Haven estate were met by Kelley Drye's efforts to diminish the value of the New Haven estate. The inevitable consequence of Manufacturers' serious conflict of interest is that what its right hand--New Haven counsel--was giving, its left hand--Penn Central counsel--was and still is taking away. What the court said in Wolf on the insider statute applies here to the different type of conflict:

> "That the rule occasionally bars compensation to those whose conduct might not have been considered inequitable or disloyal in the absence of such a statute is no reason to suspend or make selective the operation of the statute's sanctions." 372 U.S. at 655-56.

Moreover, in ruling that the good faith, but tainted fiduciary must forfeit past compensation as well as future compensation, the Court in Wolf answered any potential argument of Manufacturers that it should be compensated for attorneys' fees incurred prior to the conflict:

> "It is argued, however, that to require restitution at this late date, particularly when the trading involved small amounts of stock and was carried on apparently in good faith and without knowledge of the existence of §249, imposes an unduly harsh sanction--a remedy disproportionate to the offense. While we recognize that in a case such as this the remedy is indeed a severe one, we cannot find that Congress intended anything less. To hold that one who trades in violation of §249 forfeits only his right to future compensation would place a premium on concealment of transactions in the Debtor's stock and thereby jeopardize the salutary policies of the statute." 372 U.S. at 654. (Emphasis added.)

Conclusion

As counsel to the New Haven Trustee stated in the court below:

> "Now, certainly, a past conflict of interest--and that cannot be denied, and in our point of view there is a continuing conflict of interest.
>
> "The morality of a trustee is something that should be a little better than that of a barker at a carnival, and, yet, Manufacturers Hanover was the trustee in the New Haven reorganization for a good many years, and then when the conflict of interest arose, not only opposed New Haven, but walked out on New Haven in the sense that it resigned that trusteeship and assumed or kept the seventeen or eighteen it now has.
>
> "We think that's wrong under trust law, and we think it's wrong on any standard of morality that's above that of the common marketplace." (A556-557.)

To grant a court discretion to make an allowance from the New Haven estate of $1,535,568.83 to Manufacturers--impeding as it has and is the New Haven reorganization--would thwart the proud boast that:

> "Equity tolerates in bankruptcy trustees no interest adverse to the trust. This is not because such interests are always corrupt but because they are always corrupting...." Mosser v. Darrow, supra, 314 U.S. at 217.

For these reasons, then, that portion of the judgment of the court below which granted Manufacturers' petition for payment for services and expenses should be--and the Successor Trustees respectfully request that it be--reversed.

Dated at Bridgeport, Connecticut, this 26th day of November, 1976.

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DOCKET NO. 76-5025,
76,5030,
76,5033,
76-5037-8

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

In the Matter of The New York, New Haven
and Hartford Railroad Company, Debtor

LAWRENCE W. IANNOTTI, Successor Indenture Trustee Under The New York, New Haven And Hartford Railroad Company's First And Refunding Mortgage Dated As Of July 1, 1947; and

JACOB D. ZELDES, Successor Indenture Trustee Under The New York, New Haven And Hartford Railroad Company's General Income Mortgage Dated As Of July 1, 1947,

Appellants

MANUFACTURERS HANOVER TRUST COMPANY, Former Indenture Trustee Under The New York, New Haven And Hartford Railroad Company's First And Refunding Mortgage Dated As Of July 1, 1947; and

RICHARD JOYCE SMITH, Trustee Of The Property Of The New York, New Haven And Hartford Railroad Company, Debtor,

Appellees

CERTIFICATE OF SERVICE

I, Elaine S. Amendola, attorney for appellant, Jacob D. Zeldes, Successor Indenture Trustee Under The New York, New Haven And Hartford Railroad Company's General Income Mortgage Dated As Of July 1, 1947, in the above-entitled matter, hereby certify that on the 29th day of November, 1976, I served the attached Brief of Successor Indenture Trustees and Joint Appendix (Vol. I

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